FARMERS' NEWSLETTER
Feed Grains

December 81/F-20

Prices Lower This Year

Record U.S. feed grain crops and sluggish economic conditions here and abroad are hurting feed grain prices. Here are average farm prices expected this marketing year:

	1981/82	last year
Corn ($/bu.)	$2.55-2.80	3.10
Sorghum	2.35-2.55	2.95
Barley	2.45-2.60	2.91
Oats	1.80-1.90	1.82

With prices this bearish, farmers will want to take special care to choose a marketing strategy that will yield the best possible returns. Also, recent changes in the tax laws should be taken into account.

What About a Regular 9-Month Price Support Loan?

National average loan rates for 1981 crops are: corn $2.40 a bushel, sorghum $2.28, barley $1.95, and oats $1.24. Rates for your county are likely to differ somewhat from these averages. Loans are available from your county ASCS office through March 31 for barley and oats and through May 31 for corn and sorghum.

The interest rate is 14.5 percent through January 31. On February 1, the rate on existing loans and on new loans may be adjusted to more accurately reflect costs of borrowing from the U.S. Treasury. Regular price support loans may be repaid any time before maturity.

Regular loans provide immediate cash and allow time to assess the market or to hold grain for feeding later on. You may want to consider investing the cash at today's relatively high rates of interest, or pay off bills and loans.

The interest you would pay on the CCC loan would be a possible deduction on your tax return. Of course, interest earned from money invested may be taxed, but it could be well worth your while to put a pencil to the various options and combinations.

The Farmer-Owned Reserve: No Waiting

Farmers can immediately enter their 1981 corn, sorghum, and barley crops into the farmer-owned reserve. If 1980 crops of these grains are currently under a regular price support loan, they may be put into the reserve right away too.

Reserve loan rates for 1981 crops are higher than regular loan rates: corn is $2.55 per bushel; sorghum $2.42; and barley $2.07. Farmers placing grain in the reserve receive annual storage payments of 26-1/2 cents a bushel, payable in advance.

Interest on the 3-year reserve loans is 14.5 percent, but interest charges

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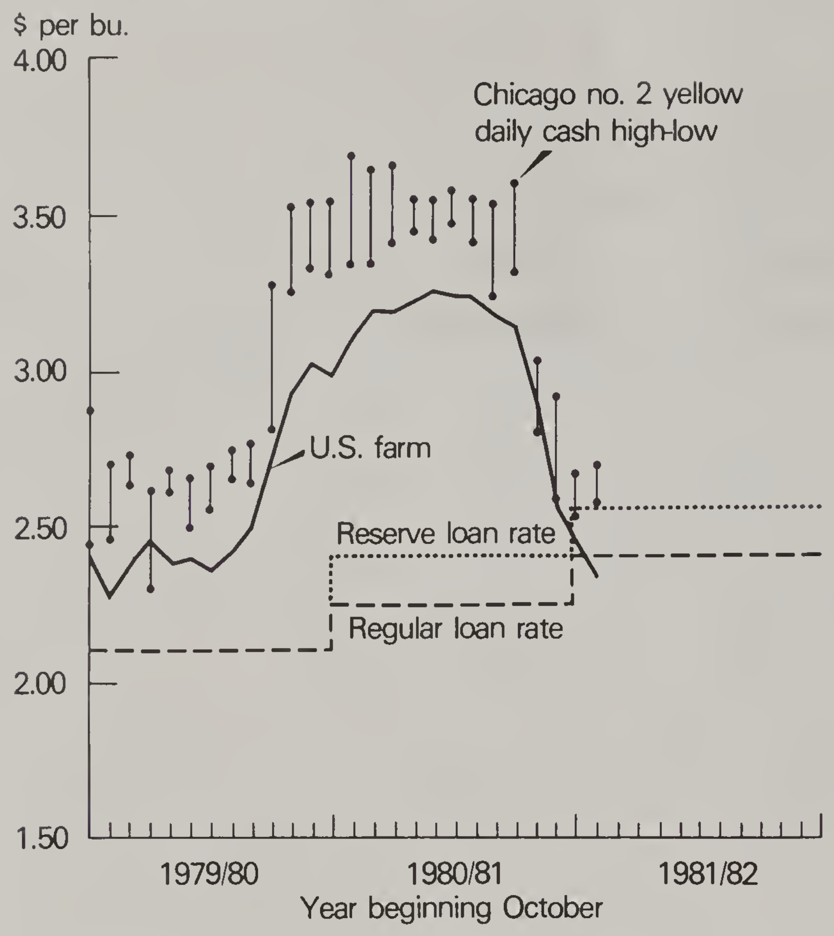
The next feed grains newsletter is scheduled for early March.

CORN PRICES BELOW A YEAR AGO



are waived after the first year. As on regular 9-month loans, the interest rate may be adjusted on February 1. Current release levels at which grain may be removed from the reserve without penalty are $3.15 a bushel for corn, $3.00 for sorghum, and $2.55 for barley.

Futures Market Offers Another Option

Although cash corn prices are much below a year ago, futures contracts for delivery later this season are trading at considerably stronger prices. The cash price of No. 2 corn at Chicago in early December was around $2.60 per bushel, while futures contracts were trading at about $2.80 for March delivery, $2.91 for May, $2.97 July, $3.01 September, and $3.06 for December 1982.

The relatively large premiums quoted for later delivery (20 cents for March, 31 cents for May, etc.) reflect the costs of holding inventories--mainly the high cost of interest and storage.

Does this situation offer an opportunity to get more for your corn by selling later? Perhaps, and if you choose to store now and sell later, you may want to consider establishing a short hedge position on the futures market to help protect you from a decline in the cash market price while you hold grain.

But you must consider how much you could earn by investing cash received from selling grain now, or what interest cost you could save by paying off loans, as well as saving storage costs. You probably would save a good deal more by paying high-interest debts than you could earn from investments.

Also, you'll want to figure the costs of making a futures contract. These include brokerage fees and interest on a margin deposit. The costs often vary widely from time to time, but generally are small compared with possible changes in grain prices.

In a hedging operation, you would hold grain and sell a futures contract equal to the number of bushels held in storage. Thus, your position would be long on grain and short in the futures market. Later when you sell the grain in the cash market you would at the same time buy a futures contract to offset your earlier short contract.

Generally, whatever is gained or lost by changes in the futures price is offset by an opposite change in the cash price. Therefore, while hedging helps protect against losses from a decline in cash prices, it also rules out the possibility of large gains if cash prices rise sharply.

To hedge effectively, you must know your local basis--the difference between local cash prices and futures prices--and understand the factors that affect it. The basis sometimes widens or narrows with changes in marketing conditions or transportation and other marketing costs. People at your local elevator probably can tell you what the basis is and how it has ranged through the season in recent years.

A Hedging Example

Corn prices at country elevators are considerably lower than at Chicago because of costs of moving grain to Chicago and high storage costs there--presently about 4.8 cents a bushel per month--where it is in position for delivery on a futures contract.

Let's say the local price for No. 2 corn is $2.20, versus $2.60 at Chicago. For simplicity, we'll assume the basis, or difference, will continue unchanged during the months ahead. Subtracting 40 cents from futures price quotations for delivery at Chicago gives the local price equivalent and some indication of whether holding grain would pay off.

Suppose you were considering holding corn for about 6 months, say from December to June '82. Would this pay better than by selling for cash now at $2.20? The difference between the local equivalent of the July futures contract (which you probably would close out in June) and the local cash price is 37 cents a bushel ($2.97 - 40¢ - $2.20 = 37¢).

The 37 cents is the premium you might earn by hedging and holding corn until June. However, to find out if this is better than a December sale, you must deduct all carrying costs, plus brokerage and other costs of the futures transaction. Then compare the result with what you could earn by investing the proceeds from a December sale.

If you can earn 12 percent per year on cash invested from selling corn now at $2.20 a bushel, the yield for half a year would be 13.2 cents ($2.20 x .12 ÷ 2 = 13.2¢) per bushel sold. Add to this what your out-of-pocket storage costs would be if you have on-farm storage, say 1.5 cents a bushel a month, or 9 cents for 6 months.

Therefore, total "costs" of holding corn would be 22.2 cents (13.2¢ + 9¢).

CORN FUTURES AND CASH PRICES[1]

	1982 futures contract month				
	Mar.	May	July	Sept.	Dec.
	Cents per bushel				
Early Dec. quotations, Chicago	280	291	297	301	306
Less current basis at Chicago	40	40	40	40	40
Local equivalent	240	251	257	261	266
Less early Dec. local cash price.	220	220	220	220	220
Difference[2]	20	31	37	41	46

[1] Early December 1981, typical local cash price in the western Corn Belt. [2] Estimated gross returns for storing corn from December to indicated dates.

This is less than the estimated gross returns of 37 cents from hedging. So, net returns from hedging would be about 14.8 cents (37¢ - 22.2¢), less costs of the futures transactions. Keep in mind this example assumes low storage costs. The apparent advantage of hedging would be reduced or eliminated if your storage costs are high.

The Farmer-Owned Reserve Option

There's been no other time in recent memory when farmers have had so many alternatives for marketing grain. Relatively high interest rates are pushing farmers to sell now, yet low prices make many producers want to hold out for later sale. This is what makes the loan and reserve programs important in figuring a marketing strategy.

If you have storage space available, pay particular attention to the farmer-owned reserve option. The lower prices stay, the more attractive the reserve is as an alternative to selling now. The reserve also will be attractive if prices do in fact increase after regular 9-month loans have matured.

The annual storage payments that are paid in advance, waiver of interest charges after the first year, and the

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cash from the loan provide a good deal of liquidity while you wait out the market. So regardless of what grain prices do in the next several years, the reserve may be your best option.

Let's assume that you can put corn in the reserve at the national average reserve loan rate of $2.55 a bushel. Also let's assume that your local cash price now is $2.20, your on-farm storage costs are 1.5 cents a bushel a month, and that you could earn 12 percent on cash invested. How would you come out on a reserve loan in just 6 months and in the longer term?

At the end of 6 months, you would have $2.89 for a bushel of corn held in the reserve ($2.55 loan + 26.5¢ storage payment + 16.9¢ interest - 9¢ storage cost = $2.89). This is well above the $2.33 ($2.20 + 13¢ interest) returns you would have at that time from selling now, or the possible returns of about $2.48 ($2.97 - 40¢ - 9¢ storage - cost of hedge) from a 6-month hedging operation.

The reserve would be a pretty good deal compared with selling now if you have on-farm storage. The reserve has the advantage because the loan rate is higher than cash prices in most areas and payments for storage are received each year in advance.

If you add the reserve loan of $2.55 plus annual storage payments of 26.5 cents and invest this sum at 12 percent, after the first year you would have $2.97 per bushel of corn in the reserve after deducting on-farm storage costs of 18 cents. Compounding this investment and again adding annual 26.5-cent storage payments and deducting storage costs, you would have $3.44 at the end of the second year, $3.97 at the end of the third.

This is much more than you would have by selling now at $2.20 and investing the proceeds at 12 percent: $2.46 at the end of the first year, $2.76 the second year, and $3.09 the third. On the other hand, if you pay off loans instead of investing the proceeds, the reserve still holds the advantage.

If the reserve is not released during the 3-year contract period, you could foreit the grain to the CCC and not have to pay the 37 cents first year interest ($2.55 x .145 = 37¢) on your loan. Or, if prices were more than the reserve loan plus interest ($2.55 + 37¢ = $2.92), you could come out ahead by paying the loan and interest and selling your corn.

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